IN THE

Supreme Court of the United States.

OCTOBER TERM, 1924—No. 515.

UNITED STATES OF AMERICA and FRANK K. BOWERS, Collector of Internal Revenue,

Petitioners-Appellants,

—against—

HENRY H. KAUFMAN, Trustee in Bankruptcy of Abraham Finkelstein, Israel Finkelstein and Nettie Finkelstein, individually and as co-partners trading as Finkelstein Brothers,

Appellee.

BRIEF FOR THE APPELLEE IN OPPOSITION TO MOTION FOR WRIT OF CERTIORARI.

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Of Counsel for Henry H. Kaufman,
Trustee in Bankruptcy of Finkelstein Bros.

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Statement.

The firm of Finkelstein Brothers, a copartnership, is bankrupt. The copartners, Abraham Finkelstein, Israel Finkelstein and Nettie Finkelstein, have also been individually adjudged bankrupt.

The balance of income tax for the year 1919 amounting to \$11,523.30, with interest from January 22, 1922, is owing by Abraham Finkelstein, individually.

Henry H. Kaufman of 115 Broadway, New York, N. Y., is Trustee in Bankruptcy for both Abraham Finkelstein individually and the firm of Finkelstein Brothers.

The testimony taken before the Referee indicated that no assets of Abraham Finkelstein, individually, came into the Trustee's hands, and that the assets he holds was derived solely from property of the copartnership. The question before the Court is whether the Government may receive payment of its claim out of the copartnership funds in the hands of H. H. Kaufman, Trustee in Bankruptcy of Finkelstein Brothers.

The testimony introduced relative to the claim of the Government was adduced before Hon. John J. Townsend, Referee in Bankruptcy, on April 26, 1923, at 4 P. M. Henry H. Kaufman, Esq., the Trustee in Bankruptcy of this proceeding, who was also Receiver in this proceeding prior to his appointment as Trustee, testified that the only assets which came into his possession as Receiver or Trustee were assets and property to which title was vested in the partnership estate and that he received no assets belonging to the individual estate of Abraham Finkelstein against whom the Government asserts its claim for taxes.

The single question presented may be stated as follows: *Is the United States of America entitled to be paid, out of partnership assets in the possession of a Trustee in Bankruptcy, for a tax assessed against an individual who is a member of a partnership, ahead of general creditors of the copartnership?*

Argument.

It is contended by the appellee in this case that the question presented, as it is above stated, should be answered in the negative.

To be specific, the United States claims to be entitled to payment of its tax assessed against Abraham Finkelstein who is a member of the copartnership of Finkelstein Brothers from the partnership assets ahead of the partnership creditors. The claim of the Government for taxes is solely and peculiarly an individual debt of Abraham Finkelstein.

POINTS.

I.

The claim of the Government for Income Tax accruing for the year 1919 and assessed by the Government against Abraham Finkelstein, is an individual debt of Abraham Finkelstein and is not a debt of the partnership.

Under the Revenue Act of 1917 (Title 2, Sect. 201), a tax was imposed and assessed directly upon copartnerships.

> "Sect. 201. That in addition to the taxes under existing law and under this act there shall be levied, assessed, collected, and paid for each taxable year upon the income of every corporation, partnership, or individual, a tax (hereinafter in

this title referred to as the tax) equal to the following percentages of the net income: * * *"

By virtue of this section the Government assessed a tax against every *corporation, partnership or individual.* Congress repealed the Act of 1917 and substituted in its place the Revenue Act of 1918 (Act of February 24, 1919, 40 Stat. 1057).

Section 218 (a) which is hereinafter set forth at length, provides that individuals carrying on business as partnership, "shall be liable for tax only in their individual capacity."

> "SECT. 218 (a). *That individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.* (Italics ours.) There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year, or, if his net income for such taxable year is computed upon the basis of a period different from that upon the basis of which the net income of the partnership is computed, then his distributive share of the net income of the partnership for any accounting period of the partnership ending within the fiscal or calendar year upon the basis of which the partner's net income is computed."

Previous to the repeal of the Revenue Act of 1917, Congress provided that a tax shall be levied, assessed and collected from every corporation, partnership or individual. The Revenue Act of 1918, which was substituted in the place of the Revenue Act of 1917, Section 201 specif-

ically provides that individuals carrying on business in partnership shall be liable for income tax "only in their individual capacity." The section, in addition to providing for the assessment of the tax against individuals and not against partnerships, defines the manner in which the tax shall be computed.

Section 224, which is set forth at length (on p. 28, Transcript of Record), provides that a partnership shall file a return setting forth specifically which is gross income, the net income, the names and addresses of individuals entitled to participate in the net income of the partnership. The purpose of this section is to enable the Government to verify the returns filed of individuals who are members of partnerships. Congress by the repeal of the Revenue Act of 1917 (Title 2, Section 201), completely changed the method of deriving revenue. It was clearly the intention of Congress to make individuals of partnerships liable personally and in their individual capacity. Congress repealed *in toto* the Revenue Act of 1917 which provided for the assessment of a tax on partnerships and substituted in its place the Revenue Act of 1918 which provides for the assessment of a tax against individuals. Congress provided for the collection of the taxes by the Revised Statutes of the United States (Sections 3186, 3187, Stat. 1016), which provides that a lien is created upon all property and rights to property belonging to such persons.

Sections 3466 and 3477 of the Revised Statutes provide that the Government shall have a prior lien or preference upon all assets of an insolvent or deceased debtor, and that a representative of an insolvent and deceased person should become answerable in his own

person, should he fail to pay the tax of the United States prior to other debts.

It is evident that the intention of Congress by the enactment of Sections 3466, 3467, herein cited, and hereinafter set forth at length, was to protect and give to the United States a lien upon assets belonging to an insolvent or deceased debtor. There is nothing, however, in the statute that would indicate that the intention of Congress was, by the enactment of Section 218 (a) of the Revenue Act of 1918, which repealed in entirety Section 201 of the Revenue Act of 1917, to make a partnership liable for the debt of an individual member of the copartnership. *The lien is created against property belonging to the individual.*

Congress repealed the Act of 1917 which provided for a tax assessed against a partnership. It is evident that no other conclusion can be drawn but that the intention of Congress was to make the individual member of a partnership, and not the partnership, liable for taxes. If it were not, the intention of Congress to make individuals liable in their own individual capacity for taxes accruing from profits made in a partnership, there would have been no purpose for Congress to nullify the Revenue Act of 1917 and substitute in its place Section 218 (a) of the Revenue Act of 1918, which effects a complete revision of the Revenue Act of 1917.

Sections 3466 and 3467 read as follows:

> "SEC. 3466. Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due

to the United States shall be first satisfied; and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed."

"SEC. 3467. Every executor, administrator, or assignee, or other person, who pays any debt due by the person or estate from whom or for which he acts, before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate for the debts so due to the United States, or for so much thereof as may remain due and unpaid.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount shall be a lien in favor of the United States from the time when the assessment list was received by the collector, except when otherwise provided, until paid, with the interest, penalties, and costs that may accrue in addition thereto upon all property and rights to property belonging to such person: Provided, however, that such lien shall not be valid as against any mortgagee, purchaser, or judgment creditor until notice of such lien shall be filed by the collector in the office of the clerk of the district court of the district within which the property subject to such lien is situated: Provided further, Whenever any State by appropriate legislation authorizes the filing of such notice in the office of the registrar or recorder of

deeds of the counties of that State, or in the State of Louisiana in the parishes thereof, then such lien shall not be valid in that State as against any mortgagee, purchaser, or judgment creditor, until such notice shall be filed in the office of the registrar or recorder of deeds of the county or counties, or parish or parishes in the State of Louisiana, within which the property subject to the lien is situated."

Section 3186 of the Revised Statutes of the United States (37 Stat. 1016) is concise and it is evident from the language of the statute that a lien created for taxes takes effect only upon property belonging to the delinquent at the time the demand for the payment of the tax is made, and then attaches to the delinquent's property.

In the case of *United States* v. *Pacific Railroad*, 1 Fed. 97, the United States filed a bill in equity to enforce a lien upon property formerly owned by the Pacific Railroad for taxes. When the tax accrued, the Pacific Railroad was the owner of the property against which the lien was sought to be enforced, but since that time, several large mortgages were executed upon the property, and under a foreclosure of one of these, the property was sold to an individual who subsequently conveyed the property to the Missouri Pacific Railway Company who was the owner at the time the suit was commenced.

The Government alleged in its bill, that demands were made for the payment of the taxes, which demands were made subsequent to the execution of the mortgages and the purchase of the property by the present owner. The defendants demurred to the bill on the ground that even

if the Government had a lien, it only took effect at the time the demand is alleged to have been made and since it was made subsequent to the sale and conveyance of the property the Government's claim is subject thereto.

The Court in construing the words of the statute "upon all property and rights of property belonging to such person, bank, association, company or corporation" (same language is contained in present section), held that the section applied to the property belonging to the Pacific Railroad Company when demand was made, by which the lien was created.

Mr. Justice Miller in the case of *U. S.* v. *Pacific Railroad Co.*, 4 Dillon 71, said:

> "In construing this section, it is proper to consider the extraordinary nature of this lien; it is not only a lien upon the land but is a lien upon personal property; it is not only a lien upon property in possession but upon all rights to property depending upon contracts, and upon unexecuted contracts; it not only relates a present lien but it relates back."

Justice McCrary (*U. S.* v. *Pacific R. R.*, 1 Fed. 97), on p. 99, in construing the opinion of Mr. Justice Miller, said:

> "I think I am within the spirit of that opinion when I say that the statute should not be construed as subjecting property which has been conveyed to innocent persons prior to any demand. Unless this is its plain meaning, the consequences of such a ruling would be so serious and far-reaching that I should not be willing to invoke them by any doubtful interpretation."

The section which was construed by the Court in this case is practically identical with Section 3186 of the Revised Statutes, *supra.* Congress if it intended that partnerships should be made liable for debts of its individual members and that a lien should attach against partnership assets, would have expressed itself in unequivocal terms.

The primary question involved in this claim is whether Congress intended by the repeal of the Revenue Act of 1917 to create a tax against the individual members of a partnership or whether it intended to create a tax against the partnership as an entity. That is the only question involved. The language of Section 218 (a), *supra,* clearly indicates that the intention of Congress was to create a tax against individual members of a copartnership and not against the copartnership itself. The language of the new section is clear, and the intention of Congress is apparent.

In the case of *Union Central Life Insurance Co.* v. *Champlain Co., et al.*, 116 Fed. 858, on p. 860, Sanborn, Circuit Judge, said:

> "The courts may not import into a plain and unambiguous law and give effect to a supposed intention or purpose of the legislative body which is neither expressed nor indicated in the act. Such a course of action would pass beyond the limits of construction or interpretation into the forbidden domain of judicial legislation."

The Revenue Act of 1918 is plain and unambiguous in its terms. It is apparent from the first sentence of the section that Congress clearly intended that an in-

dividual member of the firm shall become liable in his individual capacity. The first sentence of Section 218 (a) of the Revenue Act of 1918 is as follows:

> "That individuals carrying on business in partnership shall be liable for income tax only in their individual capacity."

There is no other deduction that can be drawn from the first sentence of Section 218 (a) of the Revenue Act of 1918 but that Congress clearly intended to create a liability against the individuals only. If the contention of the Government is correct that Congress intended by the Revenue Act of 1918 to make both the individual members of the firm and the partnership liable there would have been no purpose for Congress to repeal the Revenue Act of 1917, and substitute in its place the new section which in unequivocal terms creates a tax against the individuals only.

The elementary and primary rule of law in order to ascertain the legislative intent is that a statute is to receive the meaning which the ordinary reading of its language warrants. The language of the statute is clear and demands but one meaning. The statute would be intended to mean what it has clearly and plainly expressed, and there is no room for construction.

In *Re Southern Railway Company* v. *Machinists Local Union, No. 14, et al.*, 111 Fed. 49, the learned Judge, in his opinion in substance, said "that it is not for the Courts to inquire as to the motive of the legislature nor to limit the meaning clearly conveyed in unambiguous words."

Nothing in this issue is better illustrative of the

intention of Congress than a comparison of the Revenue Act of 1917 which Congress repealed and the Revenue Act of 1918 which was enacted in its place. One conclusion can only be drawn as to the intention of Congress. The change is apparent. It is a complete reversal on the part of Congress as to the manner in which revenue shall be derived.

II.

A claim for taxes assessed against an individual, who is a member of a copartnership, is payable from his individual assets and from his separate estate; not from assets which belong to a copartnership of which he is a member.

The rule of law is well settled that the effects of a copartnership cannot be applied by one partner to the payment of his private debts, and title of the copartnership assets is not vested in a separate creditor of one of the partners, nor is title to any of the property of the copartnership vested separately in the individual members of the copartnership. Title to the partnership assets is vested jointly in all the members of the copartnership. The Bankruptcy Act of 1898, Section 5 F, provides that the net proceeds of the partnership property shall be appropriated to the payment of the partnership debts.

The fact that there are no partnership assets available for distribution to partnership creditors or vice versa, is not sufficient to create grounds for deviating from the rule of distribution as laid down in Section 5 F

of the Bankruptcy Act of 1898. This section is so definite as to provide a uniform rule of distribution against which there can be no exception introduced by judicial construction.

In *Re Farmers & Mechanics National Bank of Philadelphia* v. *Ridge Avenue Bank,* 240 U. S. 498, Mr. Chief Justice White delivering the opinion of the Court, in substance decided, under Subdivision F of Section 5 of the Bankruptcy Act of 1898, when a partnership is insolvent and when each individual member is also insolvent, and when the only fund for distribution is produced by the individual estate of one member, the individual creditors of that member are entitled to priority in the distribution of the fund.

The principle of law involved in this issue is well settled, and the Courts have held that even where an appropriation to the individual debt of one partner is made of any part of the firm property even with the assent of the copartner the appropriation is illegal and void if the firm is not left with sufficient money to pay its copartnership debts.

Menagh v. *Whitwell*, 52 N. Y. 146.

The principle cited is an equitable principle and was embodied by Congress as a statutory requirement and as a provisional remedy under the Bankruptcy Act by the embodiment of the principle in Section 5 F of the Bankruptcy Act. This rule of law is well settled and has been recognized as an equitable principle of law by the Chancellors of England. The Courts have even held that where the claims of creditors of a copartnership have been reduced to judgment either before or after the

filing of the petition in bankruptcy of the firm and the partners, the fact that the judgment has been rendered does not in any way change the character of the claim and the assets must be distributed in accordance with Section 5 F of the Bankruptcy Act.

In re F. J. Hacker & Co., et al., 225 Fed. 869.

The claim of the Government in this case is a liability against Abraham Finkelstein in his individual capacity. This is peculiarly an individual liability of Abraham Finkelstein only. There is no liability imposed upon the other members of the firm. A liability is only imposed upon each of the members of the partnership for debts created by the partnership as an entity. It requires no citations to state that an individual may contract debts in his individual capacity even though he may be a member of a copartnership.

The only difference in the issue involved here and where an individual who is a member of a copartnership contracts or incurs a debt in his individual capacity is that in one he agrees to become liable by his own assent and in the other a compulsory contribution for the support of the Government is assessed. In both cases, it is needless to say, he is liable. One arises as a result of contract, and the other is imposed by law. It is, therefore, evident that if an individual who may be a member of a partnership acts in his individual capacity and creates obligations in his individual capacity, that the copartnership assets cannot be used to satisfy the claims created by or against the individual. The only remedy that creditors of the individual have would be to sequestrate his interest in the partnership after all the firm's liabilities have been paid.

The copartnership of Finkelstein Brothers is not responsible for an individual debt or tax of Abraham Finkelstein, the individual member. Congress has provided for the method of collecting its tax and has provided for the method in which the tax shall be assessed, all of which has been dealt with at length in Point I of this brief. Congress has in no wise deviated from the rule of marshalling assets as laid down in Section 5 F of the Bankruptcy Act, and the Government accordingly is bound by that rule.

In *Re James, et al.*, cited by the Circuit Judge of this Court, 133 Fed. 912, Lacombe, Circuit Judge, speaking on behalf of the Court, said:

> "It was within the discretion of Congress to leave this subject of the mashalling of assets to the Courts, to be disposed of in accordance with equity principles and practice, or to provide that the general rule should be modified in particular cases. It has done neither. On the contrary, it has itself directed how the assets shall be marshalled, and it has done so in language broadly covering this case as well as all the others. The language is plain, explicit and unambiguous; it names no exception; its phraseology conveys no intimation that any exception is contemplated. To inject into the act an excepting clause where none has been enacted would seem to be judicial legislation."

Congress has in no manner created any provision excepting the United States Government from this rule of law. It must be presumed, therefore, that Congress

had intended that the sovereign shall be bound by the provisions of Section 5 (f) of the Bankruptcy Act.

Section 3466, *supra*, was invoked in the case of *Guaranty Co. v. Title Guaranty Co.*, 224 U. S. 152, and the Supreme Court held that it was superseded by the Bankruptcy Act. The learned Court said at page 160:

> "The act takes into consideration, we think, the whole range of indebtedness of the bankrupt, national, state, and individual and shows the order of payment."

In *Re Hull*, 224 Fed. 796, Killits, *D. J.*, said (p. 799):

> "Indeed, it is difficult to see wherein the language of Paragraph F of Section 5 permits the grafting of an exception. The first sentence so definitely provides how various classes of debts shall be paid as to seem to leave no room for any variation. It reads:
>
> > 'The net proceeds of the partnership shall be appropriated for the payment of partnership debts, and the net proceeds of the individual estate of each partner to the payment of his individual debts.'
>
> This language, read literally, excludes opportunity for the partnership debts to participate in the fund derived from the individual estate of a partner, except as provided in the subsequent sentence of the paragraph; that is, only when the individual estate yields a surplus above the individual liabilities. In the absence of an authoritative holding in this circuit, it seems to us that the better course is to follow the second and fourth

circuits, already cited, and to hold that the statute is so definite as to provide a uniform rule of distribution against which there can be no exception introduced by judicial construction."

The appellant has cited *In re Strausberg*, 4 Woods 557, 23 Fed. case No. 13526. This citation has no bearing upon the principle involved in this claim.

In the case cited by the Government the obligation was created by reason of a bond executed by the individual members of the partnership in their individual capacity. In this case it is noteworthy to observe the language of the learned Judge in his opinion at page 558:

> "*When the United States has a claim against one member of a firm and not against the other its priority only extends to the interest of that member.*" (Italics ours.)

In *Re Lewis v. U. S.*, 92 U. S. 618, cited by the Government, obviously for two reasons. One is to uphold the contention of the Government that the United States of America as a sovereign power is in no wise bound by the Bankruptcy Act, and the other to show that the United States can assert its interest against the partnership assets for the satisfaction of the debt of an individual member.

In *Re U. S. v. Wood*, 290 Fed. 109, the Court decided the question of jurisdiction of the Court over the United States in bankruptcy matters. It distinguished the case in *Re Lewis v. U. S., supra*, and held that the United States, like any private litigant, is bound by the pro-

visions of the Bankruptcy Act and is not entitled to maintain a suit in equity against the trustee in bankruptcy to enforce its alleged priority to be first paid out of the assets in the hands of the trustee, but must proceed in the Bankruptcy Court.

This Court in its opinion rendered by Rogers, Circuit Judge, on page 113, said:

> "The present Bankruptcy Act was passed in 1898. 30 Stat. c. 541, p. 544. And in *Guarantee Company* v. *Title Guaranty Company*, 224 U. S. 152, 32 Sup. Ct. 457, 56 L. Ed. 706, the court calling attention to certain differences in the provisions of that act as compared with the Act of 1867 in respect to the priorities to which the United States is entitled under the Act of 1898, held that the United States was bound by the Act of 1898 by the provisions of section 64 of that act (Comp. St. Sec. 9648), and that labor claims have priority over debts due to the United States, except in the case of taxes legally due and owing by the bankrupt. The court in that case reversed the Circuit Court of Appeals in the Third Circuit which held (174 Fed. 385, 98 C. C. A. 603) that the United States was not bound by the Bankruptcy Act, and that under the Act of 1797 (now Revised Statutes, § 3466) the government was entitled to a prior payment irrespective of the Bankruptcy Act."

Relative to the contention of the Government under the *Lewis* case, *supra*, as to the distribution and the marshalling of assets, a reading of the case will show that the subject matter involved has no bearing upon

the issue at bar. In the case cited, the only question involved was the right of the Government to preferred payment out of the estates of the individual partners wherein the individuals were indebted to the United States and had separate estates, while the present case involves the opposite, namely, the right of the Government to preferred payment out of the partnership estate of a claim against an individual member of the partnership.

The proposition that the United States may *prove*, as a preferred creditor against an individual estate, a debt owing by a partnership of which the individual is a member is not disputed, because an individual is responsible for the debts of the partnership. The liability of an individual who is a member of a partnership is both joint and several. As an individual he owes the debt as much as the partnership, and the law clearly provides that if a debt is owing by any individual to the Government, the Government is a preferred creditor with reference to such debt and to such individual. But a partnership is not responsible for the debts of an individual partner. It, therefore, follows that the principle of the *Lewis* case is wholly inapplicable.

There can be no controversy as to the rule of law governing the relations between an insolvent firm and its creditors and their mutual rights in respect of the firm's property. The partnership as such has its own property and its own creditors, distinct from the individual property of its members and their individual creditors. The firm creditors are preferentially entitled to be paid out of firm assets, whatever may be the foundation of the equity, it is now an undisputed element in the security of the firm creditors. The in-

solvent firm cannot apply the firm assets in payment of the individual debts of the partners, nor can the equity of the firm creditors be defeated by an attempted conversion of the assets of the firm into the individual assets of one of the partners through a transfer of one partner therein to the other.

Bulger v. *Rosa*, 119 N. Y. 459.

In *Re Flatau & Stern*, 21 A. B. R. 353, a motion was made by the City of New York for an order directing the trustee in bankruptcy to pay to the City of New York the sum of $162.50 on account of taxes assessed against Nathan H. Flatau, one of the bankrupts individually. In this case the City asserted the right to be paid and its tax satisfied from the assets in the possession of the trustee which belonged to the partnership. Willis, Referee, writing the opinion in this case, on page 355, said:

> "In my judgment there can be no reasonable doubt that outside the Bankruptcy Act, a 'personal tax' is in every respect a 'debt' within the legal meaning of the word, and I can see nothing in the provisions of the Act itself to alter the situation in such regard. The act provides, however, in express terms that unpaid taxes shall be included among 'debts not affected by discharge,' and also that they shall be paid 'in advance of the payments of dividends to creditors' * * *."

In *Re McClure & Barton*, New Series, 3 A. B. R. 119, the Learned Referee followed the ruling in *Re Flatau & Stern*, *supra*, in substance decided that taxes on the property of an individual bankrupt partner will not be

paid out of partnership assets until the partnership creditors are paid in full.

Congress in enacting the Bankruptcy Act specifically mentioned the United States, and in Section 17 of the Bankruptcy Act of 1898 it provides that a discharge in bankruptcy shall release a bankrupt from all of his provable debts except such as are due as a tax levied by the United States, the State, County, District or Municipality in which he resides. Nor is the section previously cited the only one wherein the United States is specifically mentioned. The United States is mentioned in Section 64 of the Bankruptcy Act of 1898 which deals with "debts which have priority." There is but one logical and only conclusion to be drawn that Congress intended that the United States in bankruptcy matters shall submit itself to the Court which is vested with bankruptcy powers. Congress has accorded the United States every possible advantage of properly asserting its interest against one who is insolvent.

In *Re Anderson*, 279 Fed. 526, held that United States is subject to the provisions of the Bankruptcy Act. Manton, Circuit Judge, writing the opinion on behalf of the Court at page 29 stated:

> "The United States must file its claim for taxes as any other creditor, if it desires to share in the estate, and the Court must determine any question arising as to the amount or legality of such tax. It cannot stand by, as it did here after permission having been granted to file its claim, and expect to subsequently collect the tax from the bankrupt or its trustee. To permit such a procedure would make it impossible to say when

there could be a winding up of the bankruptcy proceedings and the distribution of the assets. The trustee may only pay out the assets under an order of the Referee or the Court and without such order he could not pay the income tax due the Government. If the Government had a priority it could easily be determined in this proceeding and it clearly was the intention of Congress that it should be determined under the command of Section 64, where the United States is specifically mentioned. We think that it was the intention to have settled promptly in the bankruptcy proceedings all matters of taxes due the United States. The Bankruptcy Act evidently does not contemplate that taxes should be proved, like an ordinary debt, providing, as it does, that they shall be paid by the trustee by order of the Court and that he shall have credit in his accounts upon filing receipts from the proper officials therefor."

Section 64 (a) declares:

"The Court shall order the trustee to pay all taxes legally due and owing by the bankrupt to the United States, State, County, District, or Municipality in advance of the payment of dividends to creditors and upon filing the receipts of the proper public officials for such payments he shall be credited with the amount thereof and in case any question arises as to the amount or legality as to any such tax the same shall be heard and determined by the Court."

It was determined in the *Anderson* case that the Court had the unquestioned right to determine the

amount or legality of the claim or any question that arose as a result of proving the tax claimed.

No one can doubt but that the provisions of the Bankruptcy Act are ample for the protection of the Government in proving its claim and Congress clearly intended as appears in Section 64 (a) of the Bankruptcy Act of 1898 that this Court was to exercise the exclusive and sole privilege of determining any question which may arise in connection with a claim for tax due the United States from an insolvent person, partnership or corporation. Nothing in the Bankruptcy statute provides that assets of an insolvent person, partnership or corporation shall be marshalled or distributed in any other manner than is provided for by Section 5 F.

The Government's contention is saturated with imputations of the equitable lien of the United States for taxes and the collection thereof from any source. It is needless to devote any space to the principle of law that the Government cannot seize property in payment of a debt for taxes where the person owing the tax has no legal interest, share or right to property which is held by a copartnership of which he is a member.

In order to fully counteract the imputation throughout the brief filed on behalf of the Government, it is necessary to resort to the academic principles of partnership law. It is axiomatic and requires no citation of law that a creditor of an individual who is a member of a partnership cannot assert or satisfy his claim from the assets of a partnership beyond the interest which the individual member may have in the partnership. In simple and concise terms it would simply mean that the debts of the partnership creditors would have to be

satisfied before the interest of any individual member of the partnership could be determined.

The Government's contention merely reduces itself to an absurdity and is tantamount to saying that the Government is entitled to assert a lien against the individual's assets or against any assets, whether his or not, that may be found in a partnership of which he is a member.

The Court is not concerned whether the trustee in bankruptcy or Finkelstein Brothers has assets which belong to Abraham Finkelstein individually. The order of the Referee dated August 24, 1923, provides that the claim of Frank K. Bowers as Collector of Internal Revenue of the Second Collection District of New York be allowed as a claim against the individual assets of the bankrupt Abraham Finkelstein (Rec., p. 18).

The question before this Court is whether the Government has a claim against Finkelstein Brothers as a copartnership or against Abraham Finkelstein who is a member of that corporation.

Partnerships and corporations are in effect the same to this end; both constitute an aggregation of divergent and plural interests, and to that end it may be said that in effect each is a separate entity and is formed for the sole purpose of holding interests under one supreme power.

The revised statute specifically provides that a corporation shall file a return for all its taxable income and that a corporation shall be held responsible for the tax. Congress, if it saw fit could have exempted corporations from taxation and provided that individual stockholders of the corporation were to be held responsible for their undistributed share in the corpora-

tion. In the case of partnerships it is not as in the case of corporations, Congress has by concise terms created a lien for taxes against individual members of partnership but not against the partnership as an entity, and the act specifically provides that individuals shall file returns setting forth their income and that they shall be taxed thereon, and partnerships are only directed to notify the Government by return as to the taxable income of the individuals. A tax upon the return of the partnership is not computed or assessed against the partnership. It is fair to assume that the provision for the filing of a return by the partnership is merely a precaution taken by Congress to insure the proper collection of taxes by the Government from the individuals.

The interest of an individual member in a partnership attaches, only, after the payment of the partnership debts.

In *Re L. Stein & Co.*, 127 Fed. 547, Jenkins, Cir. Judge, said:

> "The present bankruptcy act recognizes the equitable rule that partnership property is primarily a fund for the payment of copartnership debts, and that the interest of a copartner is subject to that special equity, and attaches only to the surplus remaining after the payment of the partnership debts. It treats the copartnership as a legal entity, irrespective of the status or the separate rights of the individual copartners. It deals with the copartnership as a person for the purpose of subjecting the partnership property to the satisfaction of the copartnership liabilities."

In the case of *Schnall* v. *Camers*, 251 U. S. 239, the

Supreme Court of the United States emphasized the distinction between individual debts and partnership debts saying:

> "Hence the distinction between individual and firm debts is a matter of substance, and must depend upon the essential character of the transactions out of which they arise. And since, in this case, the tort was done in the course of the partnership business, for the benefit of the firm and without benefit to the partners as individuals no legal or equitable claim as against the individuals that might be deemed to arise out of it by waiver of the tort or otherwise, can displace the equities of other creditors, recognized in the Bankruptcy Act, and put petitioners in a position of equality with others who actually were creditors of the individual partners, and of preference over other firm creditors."

In this case, the controlling provisions of law specifically and unquestionably make the Government's claim one against the individuals and only against the individuals. The partners are "liable for tax only in their individual capacity." Partnerships are not subject to any tax whatsoever. The Government cannot therefore be put in a position of priority or even equality with others who actually were creditors of the partnership, because "the net proceeds of the partnership property shall be appropriated to the payment of partnership debts" (Section 5 (f) Bankruptcy Act), and this is not a partnership debt.

The appellant in its brief refers to the fact that the distributive share of the partnership income for 1919 left by Abraham Finkelstein in the partnership was

$59,440.99. The appellant in its brief submitted to the Circuit Court of Appeals for the Second Circuit referred to a balance sheet attached to the partnership return showing the net worth of Abraham Finkelstein. There is no proof, and the record does not contain any reference to the balance sheet attached to the return or any intimation, as to what the distributive share of Abraham Finkelstein was for 1919. It is therefore assumed that for the purpose of this issue it is unnecessary to discuss the point. Assuming, however, that there was a distributive share accruing to Abraham Finkelstein of $55,440.99 for 1919 it would not necessarily indicate that at the time the appellant's lien for taxes accrued that there was due Abraham Finkelstein the distributive share which he left with the partnership.

None of the profits due Abraham Finkelstein from the partnership of Finkelstein Brothers was set aside or put into a separate fund, solely for the use of Abraham Finkelstein. It is immaterial whether the profits which accrued to Abraham Finkelstein were withdrawn from the firm assets or not, for the purpose of this discussion. There is nothing in the record to show that a division was made or any separate account created to preserve the individual interest of Abraham Finkelstein. Abraham Finkelstein's interest in the partnership was undivided and merged with the interest of the other partners.

The Government in its brief prominently cites the case of *Brazen & Schaefer*, 279 Fed. 300, decided by Judge Runyon in the U. S. D. C. for the District of New Jersey. A reading of the learned Judge's opinion in this case will clearly indicate that the primary and moving

cause for his decision was the definition as to the meaning of a tax. The learned Judge stated in his opinion:

> "The Government's claim for taxes is not to be classed with a creditor's for payment of an ordinary debt, for 'taxes are not debts but imposts levied for the support of the Government.'" (Appendix, p. 38 of Government's brief.)

Section 8 of the Constitution of the United States would clearly indicate that the framers of the Constitution of the United States intended that the word tax was to mean something other than an impost. Section 8 of the Constitution of the United States reads:

> "The Congress shall have power to lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defense and general welfare of the United States; but all duties, imposts and excises shall be uniform throughout the United States."

The framers of the Constitution did not intend to classify taxes with duties, imposts or excises, and specifically exempted "taxes" from that provision of Section 8 of the Constitution, which provides that "all duties, imposts and excises shall be uniform throughout the United States."

The District Court for the Southern District of Florida, in *U. S.* v. 59 *Demijohn*, 32 Fed. 401, by Locke, *D. J.*, said:

> "It is true the word 'tax' in its most extended sense may include all contributions imposed by the government of whatsoever kind and descrip-

tion whether against person or property, but in its more confined sense it is used in contra-distinguishment of duties and imposts. * * * In a careful examination of the numerous instances in which the word 'tax' is used throughout the entire statutes of the United States, I have failed to find one where it can with any degree of satisfaction be applied to duties and imposts. The early legislation of the country upon revenue appears to show it to have adopted the restricted use of the term and they used it in no other sense. * * * The term 'tax' was only intended to apply to the internal revenue and the term 'duty' and 'import duty' to customs."

In *Re James Pedlow & Co.*, 32 A. B. R. 808, it was held that a judgment obtained by the United States for a loss of revenue arising out of undervaluation, by the bankrupt, of imports is not a tax within the meaning of Section 64 (a) of the Bankruptcy Act entitling the Government to priority. The trustee in the *Pedlow* case claimed that "debts" due to the United States are not entitled to priority under the Bankruptcy Act but only taxes are so entitled and that "duties" are not "taxes." The United States, however, claimed that it is wholly immaterial what name may be given to a tax under Section 64 (a); it is none the less a "tax" because it is given another name. The main question presented to the Court in the case was whether the judgment obtained by the United States is for a tax duty, impost or excise, mentioned in the Constitution, Section 8 of Article 1. There is a clear distinction between "tax" and "duties" provided in the Constitution. "Duties" must be uniform throughout the United States. There is no restriction as to "taxes."

"Taxes" are used in the Constitution in their "natural and obvious sense," and are not to be enlarged or narrowed from their "natural and obvious import."

In support of that, *Block* v. *Farmer's Loan & Trust Co.*, 158 U. S. 601.

Revenue laws should be strictly construed in favor of the citizen against the Government.

U. S. v. *Wigglesworth*, 2 Story, 369.

"Taxes" and "duties" are separate and distinct under the statutes of the United States. The Bankruptcy Act of 1867 gave priority to all debts due to the United States and all taxes and assessments under the laws thereof (Act of 1867, Sec. 28). The present Act gives priority only to "all taxes legally due and owing by the bankrupt to the United States" (Sec. 64).

The change of the phraseology of the Act of 1867 and the Act of 1898 giving priority to the United States is significant.

The Bankruptcy Act is uniform and exclusive throughout the United States and the Bankruptcy Court supreme as to all matters within its jurisdiction. The obvious conclusion to be drawn from the numerous decisions by the Court is that "taxes" are different and import a meaning different than "imposts or excises." If, as the learned Judge holds in the *Brazen & Schaefer* case, that a tax is an impost, the Government would not be entitled to priority of payment and would only be entitled to share as a general creditor under the present Bankruptcy Act. The Bankruptcy Act of 1898

gives priority only to "all taxes legally due and owing by the bankrupt to the United States."

In re Pedlow, supra.

The Government's claim must either be classed as an impost or a tax, for a definite and special meaning is conveyed by each word. If the claim is an impost it is a general claim against the individual estate and if the claim is classed as a tax the Government is bound by the Bankruptcy Act which gives it a preference, since the Bankruptcy is "uniform and exclusive throughout the United States, and the Bankruptcy Court supreme as to all matters within its jurisdiction."

The Government cannot have the law construed in any manner different than it would be construed for any other creditor. The law is well settled that the debt of an individual member of a partnership is not provable against the partnership but is only provable against his individual estate.

The learned Court in the case of *Brazen & Schaefer* reached an erroneous conclusion, because of its misapplication of the well defined legal principles.

The Government's brief in support of its contention cites Section 5G of the Bankruptcy Act which in fact provides that "The Court may marshal the assets of the partnership estate and individual estates so as to secure the equitable distribution of property of the several estates." The conclusion reached by the Government in its brief regarding this section of the Bankruptcy Act is not supported by any citation or authority. The proposition was pertinently raised in the case of *Telfer*,

184 Fed. 224, and in construing Section 5G of the Bankruptcy Act, said that "this clause is construed with reference to the clause F."

The *Telfer* decision which interprets Section 5G of the Bankruptcy Act which provides:

> "That the Court may permit the proof of the claim of the partnership estate against the individual estates and vice versa, and may marshal the assets of the partnership estate and the individual estates so as to prevent preferences and to secure the equitable distribution of the property of the several estates."

Held that it does not change the established equity rule of distribution between partnership and individual creditors, which is expressly recognized in Subdivision "F"; and, while the trustee of a partnership estate may prove a claim against the individual estate of a partner such claim is not entitled to payment pro rata with those of individual creditors, but only from the surplus, if any, remaining after the individual claims have been paid.

The claim of the Government wherein it seeks to be paid, in the case at bar, from the partnership assets for an individual debt is unfounded and is not supported by any equitable or legal principle.

In *Re Bertenshaw,* 157 Fed. 363, Judge Sanborn, in the course of his opinion stated:

> "There are two conceptions of a partnership, one springing from the agreement on which it is founded, that it is an aggregation of persons as-

sociated together to share its profits and losses, owning its property, and liable for its debts. The other that it is an artificial being, a distinct entity separate in estate, in rights, and in obligations from the partners who compose it. In most of its relations to persons and things the latter conception is the more accurate."

In *Re Mills* v. *J. H. Fisher & Co.*, 159 Fed. 897, the Court in passing upon the effect of the Act of a member of a partnership in transferring the whole of his estate to satisfy the claim of a partnership creditor, Mr. Justice Lurton said:

> "A partnership under the Bankruptcy Act of 1898 is a distinct entity—a person—* * * As an entity it may be adjudged to be a bankrupt irrespective of any adjudication against the individual members."

The Government alludes to the fact that Abraham Finkelstein permitted his share of the profits of Finkelstein Brothers to remain undistributed and left all his money in the partnership estate. For the purpose of determining this issue it is immaterial whether the money was withdrawn by him from the firm or not. It is settled law; assuming Abraham Finkelstein left his share of the profits undistributed in the partnership he could not recover it until all of the partnership liabilities have been paid. The test is did the partnership hold for him in trust any money or property set aside separately and distinct from the partnership assets. In this case it did not.

In *Re Effinger*, 184 Fed. 728, the learned Court held

that the claim of a partner for money loaned to the partnership in excess of the amount he was bound to contribute as his share of the capital is unquestionably provable against the partnership estate; but it cannot share in the distribution of that estate until all of the firm creditors are paid.

In the present issue there is no contention that Abraham Finkelstein contributed more than he was bound to contribute to the partnership nor that the partnership owed him any money at the time the petition in Bankruptcy was filed. No proof has been introduced to sustain that proposition and assuming if that were the fact it would still remain wholly immaterial as far as the right of a creditor of an individual, who is a member of a partnership, to share in the partnership assets is concerned.

CONCLUSION.

For the reasons hereinbefore set out, it is urged that the United States of America is not entitled to payment of its claim against Abraham Finkelstein from the partnership assets in the possession of the trustee in bankruptcy, and that the order of the Referee in Bankruptcy, the District Court of the United States for the Southern District of New York, and the Circuit Court of Appeals for the Second Circuit, should be affirmed in all respects.

Respectfully submitted,

WALTER M. CHANDLER,
Of Counsel for Henry H. Kaufman, Trustee in Bankruptcy of Finkelstein Bros.

IN THE

Supreme Court of the United States,

OCTOBER TERM, 1924.

UNITED STATES OF AMERICA and FRANK K. BOWERS, Collector of Internal Revenue,

Petitioners,

AGAINST

ALFRED C. COXE, JR., as Receiver of JONES & BAKER, alleged bankrupts.

No. 516.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Preliminary.

A single petition has been filed in cases No. 515 and 516 for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit. This brief is in opposition to the petition in case No. 516, although substantially the same question of law is involved in both cases, and a single opinion was written in the Circuit Court of Appeals in determining them. (See Opinion printed in appendix.)

ARGUMENT.

I.

The United States is not entitled to have the partnership assets applied to the payment of taxes due to it from the individual members, prior to the payment of the partnership creditors.

The claim of the United States is for taxes due from W. R. Jones and Jackson B. Sells as individuals only (fols. 38, 44, 50, 56). The two claims were entitled in the bankruptcy proceedings and were specifically stated to be against the individuals. We understand it to be conceded that there is no indebtedness for taxes due the United States from the partnership. Under the 1918 Revenue Act it is admitted taxes could only be assessed against the individuals. Sections 218-A and 224 of the 1918 Revenue Act provide as follows:

> "Section 218 subdivision A: That individuals carrying on business in partnership shall be liable for income tax only in their individual capacity."

> Section 224: That every partnership shall make a return for each taxable year stating specifically the items of its gross income and the deductions allowed by this title and shall include in the returns the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners."

The partnership is required to furnish the necessary information return to enable the government properly to determine the amount of income tax

assessable against the individual partners. The partnership is not made liable for the payment of taxes. This was not true under the prior 1917 Act, which imposed a graduated excess profit tax against the partnership. (Title II, Section 201, Rev. Act of 1917.)

The Bankruptcy Act specifically provides that,—

> "The net proceeds of the partnership property shall be appropriated to the payment of the partnership debts and the net proceeds of the individual estate of each partner to the payment of his individual debts. Should any surplus remain of the property of any partner after paying his individual debts such surplus shall be added to the partnership assets and be applied to the payment of the partnership debts. Should any surplus of the partnership property remain after paying the partnership debts such surplus shall be added to the assets of the individual partners in the proportion of their respective interests in the partnership."

It has been repeatedly held that the distinction between individual and firm debts is a matter of substance and cannot be disregarded.

In re Wilcox, 94 Fed. 84;
In re Janes, 133 Fed. 912;
In re Schall vs. *Camors,* 251 U. S. 239.

In the brief submitted in support of the petition it is stated that it was admitted that there were no individual assets. This may be true in the *Finkelstein* case (No. 515) but it is not true in the *Jones & Baker* case. Both the partners, Jones and Sells, had individual estates, now in the hands of the Receiver, although not sufficient to pay the amount of the taxes due by these individuals to the government.

The decision relied upon in the petition and brief, *In the Matter of Brezin & Schaeffer* (297 Fed. 300),

decided by the District Court of New Jersey, is discussed and disposed of in the opinion of the Circuit Court of Appeals (*infra*, p. 18).

The statement in the Government brief that the decision of the court below,—

> "* * * opens the door to evasion of taxes and will seriously delay and hamper the collection of the public revenue (p. 8)"

is not only incorrect but entirely fanciful. If the individual partners are solvent, they must, of course, pay their taxes to the government. If the partnership estate is solvent then the interests of the partners may be reached. There can be no possible evasion. The partners cannot benefit in any way. The question determined by the court below was that where the assets of a partnership estate are being administered in a bankruptcy court, and are insufficient to pay the partnership creditors, then a tax assessed against the individual partners is not payble out of the partnership assets prior to the payment of the partnership creditors.

In passing upon petitions for writs of certiorari where the determination of the Circuit Court of Appeals is otherwise final, this court only concerns itself "with questions of gravity and importance".

> *Ex Parte Lau Ow Bew*, Petitioner, 141 U. S. 583.

It is respectfully submitted that the petition for a writ of certiorari to review the decree of the Circuit Court of Appeals for the Second Circuit should be denied.

Dated, September 24, 1924.

Joseph M. Hartfield,
Of Counsel for Alfred C. Coxe, Jr.,
Receiver of Jones & Baker,
Alleged bankrupts.

APPENDIX.

Opinion of Circuit Court of Appeals.

UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE SECOND CIRCUIT.

IN THE MATTER

OF

ABRAHAM FINKELSTEIN, ISRAEL FINKELSTEIN and NETTIE FINKELSTEIN, individually and as copartners trading as Finkelstein Bros.,

Bankrupts,

Re: Claim of FRANK K. BOWERS, Collector of Internal Revenue for the Second District of New York, for $11,523.30.

UNITED STATES OF AMERICA and FRANK K. BOWERS, as Collector of Internal Revenue for the Second District of New York,

Appellant,

AGAINST

HENRY H. KAUFMAN, Trustee in Bankruptcy,

Appellee.

IN THE MATTER

OF

JONES & BAKER,

Alleged Bankrupts.

Before: ROGERS, HOUGH & MAYER, *Circuit Judges.*

These two appeals were argued at the same time and will be disposed of in one opinion.

In the *Finkelstein* case the District Court for the Southern District of New York affirmed the order of the Referee in bankruptcy allowing the claim of Bowers, Collector, against the individual assets of Finkelstein, but not against the partnership assets. The facts are sufficiently set forth in the opinion of Referee Townsend which, because of its careful review of the question litigated, we quote *infra*.

In the *Jones & Baker* case, the District Court for the Southern District of New York reached the same conclusion on a different state of facts, in respect of which, however, there is no difference in principle from what was held in the *Finkelstein* case.

The facts in the *Jones & Baker* case may be briefly stated.

Jones & Baker was a partnership composed of two partners, William R. Jones and Jackson B. Sells, and was engaged in the stock brokerage business. On March 31, 1923, an involuntary bankruptcy proceeding was commenced against the firm in the District Court for the Southern District of New York and a receiver was appointed.

An offer of composition in bankruptcy was made by the firm to the partnership customers and creditors, as distinguished from the creditors of the individual partners, which contemplated the valuing of all securities in the margin accounts at their value on May 31, 1923, and the payment to the partnership customers and creditors on the resulting credit balances of at least 90% in cash and securities as so valued. No offer of composition was made to the creditors of the individual partners. This offer of composition was confirmed by the District Court, and the Receiver was directed to carry it into effect. Under the composition the

creditors of the firm cannot by any possibility recover the full amount of their claims.

In July, 1923, more than one month after the appointment of the receiver, the government, upon a re-examination of the individual tax returns of the individual partners, for the years 1918, 1919 and 1920, assessed certain additional income taxes against Jones for $632,768.04 and Sells for $62,-661.89. Separate claims for these amounts were thereupon filed with the Receiver, both dated July 14, 1923, by the Collector of Internal Revenue for the Second Collection District of New York.

These two claims were entitled in the bankruptcy proceedings and were specifically stated to be against the individuals.

Subsequently separate amended claims in identical language were filed with the Receiver for slightly reduced amounts.

As the result of negotiations, a formal stipulation was entered into under date of November 26, 1923, between the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, and Jones, by which the amount of his income tax liability for the years 1918, 1919 and 1920 was reduced to $273,739.07. Under the same date a similar stipulation was entered into with Sells reducing his net additional income tax liability for the same years to $5,518.41.

These stipulations were entered into separately with each partner, and each stipulation fully recites the facts relating to the individual assessment concerned.

The government, however, has endeavored in the bankruptcy proceeding to assert these claims as claims against the assets of the firm of Jones & Baker, collected and held by the Receiver for the

use and benefit of the creditors of the firm and has endeavored to enforce the two claims as being entitled to payment out of the firm's assets prior to the customers and creditors of the firm.

The opinion of the Referee in the *Finkelstein* case follows:

> "The Collector's claim * * * asserts a claim against Abraham Finkelstein for an unpaid balance of Income Tax for the year 1919, the balance being stated at $11,523.30. Priority in payment before all claims, together with interest at 1% per month until paid beginning January 22, 1922, is also asserted.
>
> The question of priority and of rate of interest will be reserved by the Referee for the present.
>
> The entire Income Tax for the year 1919 asserted against Abraham Finkelstein is $15,364.40 of which he appears to have paid the instalment or one-fourth normally falling due in March, 1920, at $3,841.10. The remaining three instalments or three-fourths aggregating $11,523.30 form the basis of the present claim.
>
> On October 14, 1920, a petition in bankruptcy was filed against the partnership and the partners upon which petition the three partners individually and as a partnership was adjudicated on April 1, 1921.
>
> It does not appear that the Collector prior to the filing of the petition in bankruptcy in October, 1920, ever took any steps against Abraham Finkelstein to collect the unpaid instalments of June 15, 1920, and September 15, 1920, either against the individual property of Abraham Finkelstein, including his interests in the partnership at that time.
>
> At the hearing it appeared that all the assets in the hands of the Trustee in Bankruptcy are partnership assets and that the Trustee has no assets otherwise the property

of Abraham Finkelstein. It was conceded Abraham Finkelstein had a substantial interest in any surplus of partnership assets remaining after paying partnership debts. It is, however, conceded that in this there is no surplus.

At the hearing the government contended that the Collector's claim was payable out of the partnership assets prior to the payment of the general co-partnership creditors.

At the hearing the Trustee contended that the government's claim was only payable out of any individual assets (of which in this case there were none) belonging to the individual estate of Abraham Finkelstein within subdv. *f* of Section 5 of the Bankruptcy Act.

In other words, the Government's contention is that the tax assessed against Abraham Finkelstein should be paid out of the partnership assets prior to partnership creditors the same as if the Income Tax had been assessed upon the partnership as an entity as was the case under the Revenue Act of 1917; see Title II, Section 201 of that statute which reads as follows:

> 'That in addition to the taxes under existing law and under this act there shall be levied, assessed, collected, and paid for each taxable year upon the income of every corporation, partnership, or individual, a tax (hereafter in this title referred to as the tax) equal to the following percentages of the net income. * * *'

It is to be noted that Title I of the Act of 1917 imposes an Income Tax upon the income of every individual and that Title II of the Act imposes a graduated excess profits tax on a partnership as an entity.

The Revenue Act of 1918 under which the present tax was imposed upon Abraham Finkelstein was a departure from the plan of the Revenue Act of 1917 in not imposing a tax upon a partnership as an entity but declaredly im-

posed the tax upon the partner in his individual capacity and in respect to the income, whether distributed or not, which he was entitled to receive from the partnership.

The language of the statute is as follows:

'Sec. 218 (*a*) That individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year, or, if his net income for such taxable year is computed upon the basis of a period different from that upon the basis of which the net income of the partnership is computed, then his distributive share of the net income of the partnership for any accounting period of the partnership ending within the fiscal or calendar year upon the basis of which the partner's net income is computed.'

'Sec. 224. That every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.'

It is also to be noted that these sections are found in Part II of the Revenue Act of 1918 entitled 'Part II-individuals.'

In my opinion the sovereign in the Act quoted has publicly declared its claim against the taxpayer and that the language of the statute, viz.: Section 218(*a*) impliedly, if not expressly, follows or adopts the rule of marshalling laid down in subdv. *f* of Section 5 of the Bankruptcy Act.

Had the partnership remained solvent and had the Collector pursued Abraham Finkel-

stein for the unpaid Income Tax the maximum right of the Government, in my opinion, under the statute would have been to pursue the individual assets of Abraham Finkelstein and to have pursued the latter's interest in the partnership after its affairs were marshalled under the familiar rule.

I find nothing in the Sections 3186 and 3466 or 3467 of the revised statutes of the United States which increases the *res* which the Collector may seize. Those three sections read as follows:

> 'If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount shall be a lien in favor of the United States from the time when the assessment-list was received by the collector, except when otherwise provided, until paid, with the interest, penalties, and costs that may accrue in addition thereto, upon all property and rights to property belonging to such person; * * *
>
> 'Sec. 3466. Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied, and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.'
>
> 'Sec. 3467. Every executor, administrator, or assignee, or other person, who pays any debt due by the person or estate from whom or for which he acts before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate for the

debts so due to the United States, or for so much thereof as may remain due and unpaid.'

Neither of these three sections attempts to define the assets of the taxpayer which are subject to seizure.

In my opinion the insolvency of the partnership or the partner who is the taxpayer does not increase the rights of the Government.

In other words I do not believe, because the partnership and the individual partners have become insolvent, that for that reason the Government to satisfy an unpaid tax imposed upon one partner as an individual can seize all the assets of the partnership in advance of the creditors of the partnership.

Non constat but that had the Government acted promptly in 1920 it might have secured from Abraham Finkelstein payment of at least two of the instalments of the tax out of his individual assets including his equity in the partnership.

The fact that the Government delayed collection until after such equity had disappeared and any other assets of Abraham Finkelstein had also disappeared affords no reason why the partnership assets, which otherwise would have belonged to the partnership creditors, should be now seized by the Government to pay its claim against Abraham Finelstein as an individual under Section 218(*a*) of the Revenue Act of 1918.

I repeat that the present controversy cannot be decided correctly without constantly keeping in mind the text of Sections 218 and 224 of the Revenue Act of 1918 quoted above.

Congress having deliberately chosen the plan of taxation indicated in those sections, instead as assessing the income of the partnership as an entity and making the tax thereby payable out of partnership assets in the first instance in case of a failure, the Collector is precluded from asserting the different rule here contended for by him, even if (as he points out)

the statutory plan works (as here) to leave the partnership assets to the partnership creditors free from seizure to satisfy a tax imposed on one partner 'in his individual capacity'.

I read the following cases as supporting the views expressed in this memorandum:

U. S. v. *Hack,* 8 Peters, 271;
U. S. v. *Evans, Crabbs,* 60; 2 Fed. Cases, #15,062.

The Collector relies on the following cases:

In re Straussberger, 4 Wood, 557, 23 Fed. Cases, #13,526;
Lewis v. *U. S.,* 92 U. S. 618.

In the *Straussberger* cases the United States had recovered a judgment on a whiskey bond against both of the Straussbergers who were partners in a whiskey business but who had each executed the bond in connection with that business in their individual capacities. It is evident to me that this feature was decisive of the case. The language at page 559, postponing the claims of partnership creditors as well as of separate creditors to the claim of the United States, must be read in connection with the limitation in the language of the opinion on page 558, beginning 'When the United States have a claim against one member of a firm and not against the other its priority extends only to the interest of that member, etc., etc.'

I cannot read the *Lewis* case as impairing the prior decision of the U. S. Supreme Court in *U. S.* v. *Hack.* The facts were as follows:

The United States had a claim against the partnership of Jay Cook McCullough & Co. of London, hereafter called the English firm.

On November 26, 1873, the American firm became bankrupt and Lewis was the Trustee in Bankruptcy.

The United States asserted against the Trustee in bankruptcy a claim against separate estates of the seven American partners in the American firm, they being partners in the English firm which was primarily the debtor to the United States.

The Supreme Court merely decided that the United States holding a claim primarily against the English partnership was not bound to go into a foreign jurisdiction to assert that claim against that partnership before proceeding against the separate estates of the partners in this country but could assert a claim against the separate estates of the partners so far as found in this country in the possession of Lewis the Trustee in bankruptcy of the American firm. The decision cannot in my opinion be read as authority for the converse proposition contended for by the Collector—that the United States in holding a claim against a partner as an individual may assert that claim against the partnership assets ahead of the claims of partnership creditors—which is the proposition condemned in *U. S.* v. *Hack, supra.*

I report that the Trustee in bankruptcy in this proceeding is entitled to a decree barring the claim of the Collector of Internal Revenue against the partnership assets of Finkelstein Brothers in priority to the claims of the creditors of Finkelstein Brothers.

Such order should contain a provision expressly reserving the rights of the Collector of Internal Revenue against the individual estate of Abraham Finkelstein until it is made to appear that such an estate exists in the hands of the Trustee in Bankruptcy."

ROBERT P. LEVIS (MAX E. SANDERS, of counsel), for Appellee, Henry H. Kaufman, Trustee.

WHITE & CASE (LYLE T. ALVERSON, ALFRED C. COXE, J. M. HARTFIELD, HENRY H. KAUFMAN, WM. ST. JOHN TOZER and RALPH WOLF, of counsel), for Receiver Coxe.

WILLIAM HAYWARD, U. S. Attorney, NELSON T. HARTSON, Solicitor of Internal Revenue, RUSSELL N. SHAW, Special Attorney, Bureau of Internal Revenue, and VICTOR HOUSE, Special Asst. U. S. Attorney, for Appellants.

MAYER, Circuit Judge:

The fundamental fallacy of the contention on behalf of the government is that it confuses priority with the existence of a fund out of which taxes are payable or collectible.

The authority to tax must be found somewhere. The Revenue Act of 1918, in section 1400 thereof, specifically repealed, *inter alia,* Title I including section 8(*e*) of the Revenue Act of 1916 and Title II, including section 201 of the Revenue Act of 1917.

The provisions of the tax statute here concerned are thus section 218(*a*) and section 224 of Title II of the Revenue Act of 1918. As pointed out in the opinion of the Referee, *supra,* there is not the slightest warrant for concluding that the tax was against partnerships and not solely against the "individuals carrying on business in partnership". The language of Section 218(*a*) is too plain for extended discussion, and its meaning could be fortified, if necessary, by the contrast between the Revenue Act of 1917 and the Revenue Act of 1918 in this regard.

As, therefore, there was no income tax against the partnership in either of the cases at bar, we must look to the bankruptcy statute to ascertain whether it affirmatively provided that the tax assessed against the individuals could be proved against the partnership estate. We need not pause to consider what distinction, if any, there is between "debts" and "taxes" in various parts of the Bankruptcy Act. We may also assume for the purpose of the argument that, if the Revenue Act of 1918 authorized assessment of the tax against the partnership instead of against the individuals, it might not have been necessary to name the United States in any provision as to marshalling.

The point, however, is that, as there is no tax against the partnership, the only remaining theory upon which the tax against the individuals can be proved against and recovered out of the partnership estate is that the Bankruptcy Act of 1898 so provided.

Section 5, subdivision (*f*) of that act did not so provide. This provision reads:

> "The net proceeds of the partnership property shall be appropriated to the payment of the partnership debts, and the net proceeds of the individual estate of each partner to the payment of his individual debts. Should any surplus remain of the property of any partner after paying his individual debts, such surplus shall be added to the partnership assets and be applied to the payment of the partnership debts. Should any surplus of the partnership property remain after paying the partnership debts, such surplus shall be added to the assets of the individual partners in the proportion of their respective interests in the partnership."

There can be no longer any doubt that the distinction between individual and firm debts is a matter of substance which cannot be disregarded.

In re Wilcox, 94 F. R. 84;
In re Janes, 133 F. R. 912;
In re Schall v. *Camors,* 251 U. S. 239;
In re Jarmulowsky, 287 F. R. 703.

There is, of course, no doubt that the right of priority of the United States in the collection of taxes is an attribute of sovereignty.

Marshall v. *New York,* 254 U. S. 380.

Under section 64(*a*) of the Bankruptcy Act of 1898, it is the duty of the court to order the trustee to pay all taxes, legally due and owing by the bank-

rupt to the United States, in advance of the payment of dividends to creditors; but, of course, the tax must be "legally due and owing by the bankrupt to the United States".

U. S. R. S., sections 3186, 3466 and 3467, deal with tax priority, but there is nothing in the provisions of these sections which changes the tax against an individual into a tax against the partnership. Numerous instances will be found in the case of *In re Wilson*, 252 F. R. 631, which illustrate the difference between the identity of the fund or person against whom a claim can be made and respective priorities once the fund or person is found or determined. If, therefore, the Congress had intended that the tax against the individuals should be paid out of the partnership estate prior to the payment of the partnership debts it would have so declared by some affirmative language to that effect either in sections 5(*f*) of the statute or in some other provision.

It must be remembered that the Bankruptcy Act of 1898 has now been in operation for a little over a quarter of a century and that business has been done on the faith and basis of the statute. It can readily be seen that a partnership might not be able to obtain the same amount of credit from banks and other lending sources if in marshalling the assets of a partnership, such assets become a fund out of which the debts or taxes due and owing from the individual members are payable prior to or *pari passu* with the partnership debts.

As pointed out by Judge Rogers in *United States v. Wood*, 290 F. R. 109, there is a marked difference between the Act of 1898 and previous acts in respect of the relation of the United States to the present bankruptcy act. In the case just cited, there is a review of many cases illustrative of this proposition.

It is hard to believe, in view of the definite language of section 5(*f*) that the legislature intended to create a situation where the debts or taxes due from the individuals might wipe out or share with the debts due from the partnership; for any such provision might well have been most detrimental to business and commerce. Of course, it is always within the power of the Congress to tax the partnership as distinguished from the individuals, but where, as here, no such tax exists, we confess that we are unable to find anywhere in the Bankruptcy Act of 1898 any provision which authorizes the collection of the tax from property which was never taxed.

United States v. *Hack*, 8 Peters, 271;
United States v. *Evans*, 25 Fed. Cases, 1023.

The cases of *Lewis* v. *United States*, 92 U. S. 618, and *In re Strassburger*, 23 Fed. Cas. 224, have been analyzed in the opinion of the Referee and the *Lewis* case has been further commented upon in the *Wood* case, *supra*, at pages 111 *et seq.*

Our attention has been called to a decision of the District Court of New Jersey in the *Matter of Brezin & Schaefer*, not reported. We are unable to agree with this decision. (Note.) There is nothing in the record of either of the cases at bar upon which an equitable lien against the partnership assets may be asserted in favor of the United States. "Equitable lien" is often used synonymously with "equitable assignment" and "impressing a trust". An excellent definition is found in *Lighthouse* v. *Third National Bank*, 162 N. Y., at page 344:

> "One of the first essentials to the creation of an equitable lien is the specific thing or property to which it is to attach.

Though possession is not necessary to the existence of an equitable lien, it is necessary that the property or funds upon which the lien is claimed should be distinctly traced, so that the very thing which is subject to the special charge may be proceeded against in an equitable action and sold under decree to satisfy the charge."

See also

Pomeroy on Equity, Fourth Edition, Vol. 3, Section 1233;
Bispham on Equity, 4th Edition, Sec. 351;
Ketchum v. *St. Louis*, 101 U. S. 306;
Walker v. *Brown*, 165 U. S. 654;
National City Bank v. *Hotchkiss*, 231 U. S. 50, 57;
In re National Cash Register Co., 174 F. R. 579;
In re See, 209 F. R. 172.

Every element of an equitable lien is absent in each of the cases here under consideration.

Finally, there is no merit in the suggestion that the marshalling provisions are not applicable in the *Jones & Baker* case because there the composition in that case was had before adjudication. The composition was only with the partnership creditors and there was no composition with the creditors of the individual partners. This was warranted by Section 12 of the Bankruptcy Act, as amended June 25, 1910. *In re Breitbart*. 291 F. R. 693.

A composition whether before or after adjudication, so far as affects the questions here presented, stands in the same position as a liquidation through a trusteeship in bankruptcy. (See opinion of Referee Remington, *Matter of Simon Fox*, 6 A. B. R. 525, 530.)

It is plain that under the Bankruptcy Act, it is intended that its administrative sections shall apply whichever method of administration may be chosen.

We think it unnecessary to comment in detail upon many cases cited in the briefs. It is sufficient to observe that three cases upon which some emphasis is laid by appellant, *i. e., Matter of Menist,* 294 F. R. 532; *U. S.* v. *McHatton et al.,* 266 F. R. 602, and *Titus* v. *Maxwell,* 281 F. R. 433, either are not relevant to the question here under consideration or contain nothing to disturb the conclusion that the decrees below were correct.

Decrees affirmed.

(*Note.*) See interesting article in *Columbia Law Review,* April, 1924, entitled "The Priority of the United States in the Payment of its Claims against a Bankrupt", by Ralph F. Colin, at pages 360, 371 and 372.

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No. 515

IN THE

Supreme Court of the United States

OCTOBER TERM, 1934.

UNITED STATES OF AMERICA and FRANK K. BOWERS, Collector of Internal Revenue,

Petitioners,

vs.

HENRY H. KAUFMAN, Trustee in Bankruptcy of ABRAHAM FINKELSTEIN, ISRAEL FINKELSTEIN and NETTIE FINKELSTEIN, individually and as co-partners, trading as FINKELSTEIN BROS.,

Bankrupts.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

WM. SIEBRIST, INC., PRINTER, 9-15 MURRAY ST., N. Y.

IN THE

Supreme Court of the United States,

OCTOBER TERM, 1924

UNITED STATES OF AMERICA and FRANK K. BOWERS, Collector of Internal Revenue, Petitioners, *against* HENRY H. KAUFMAN, Trustee in Bankruptcy of ABRAHAM FINKELSTEIN, ISRAEL FINKELSTEIN and NETTIE FINKELSTEIN, individually and as co-partners trading as FINKELSTEIN BROS., Bankrupts.	No. 515

Brief in Opposition to Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

A single petition has been filed in cases 515 and 516 for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit.

A brief in opposition to the petition in case No. 516 has been submitted, to which there is appended the opinion of the Circuit Court of Appeals for the Second Circuit.

The opinion of the Circuit Court of Appeals

contains a copy of the opinion written by the Referee in Bankruptcy.

The arguments advanced in the brief submitted in case No. 516 are relied upon in this proceeding. The facts in case No. 516 are substantially alike.

This learned Court is respectfully referred to the brief filed in case No. 516 and we rely upon the opinion rendered by the Circuit Court of Appeals for the Second Circuit, and upon the arguments advanced by counsel in case No. 516.

It is respectfully submitted that the petition for writ of certiorari to review the decree of the Circuit Court of Appeals for the Second Circuit should be denied.

Dated, New York, October 2, 1924.

JONAH J. GOLDSTEIN,
Counsel for Henry H. Kaufman,
Trustee in Bankruptcy of
Finkelstein Bros.